

Understanding Bear Markets and Recessions, and How to Profit from Them: Basing, the Last Phase of a Bear Market

This will be the sixth Special Report on bear markets and recessions. This report will focus on the last phase of a bear market, the basing period. We will try to answer the questions: why are they important; how long do they last and what do they look like?

We will issue one more Special Report on bear markets and recessions. In that report we will summarize what we've taught and analyze the current bear market using the concepts we've learned in these special reports.

Summary of the Phases of a Bear Market

Let's summarize the different phases of a bear market:

- A major reversal pattern, the market going from a bull market to a bear market
- Decline phase, lower highs and lower lows
- Panic Phases
- Finding a bottom
- Basing and the formation of a major reversal pattern
- Breaking out of a bear market to a new bull market

Basing

Bear markets need to find a bottom and then base.

Bases are like diving boards: the longer the diving board, the bigger the bounce, the shorter the diving board the smaller the bounce. You normally want to see a long base. V like bottoms are rare.

The base will also form a major reversal pattern, the opposite of tops: double bottoms, head and shoulder bottoms, triple bottoms, bowl shaped bottom (opposite of umbrella top) and V shaped bottoms (very rare). Basing, bottoming and major market reversal patterns of a bear market are used interchangeably.

Once prices base and form a bear market bottom, the market can set itself up for the next bull market. Buying during the late phase of the basing phase can be very profitable for the investor who wants to buy and hold for the next three to five years bull market cycle. Rolling up long-term leaps could also be a good strategy.

Why Prices Need to Base

There are several reasons why prices need to base:

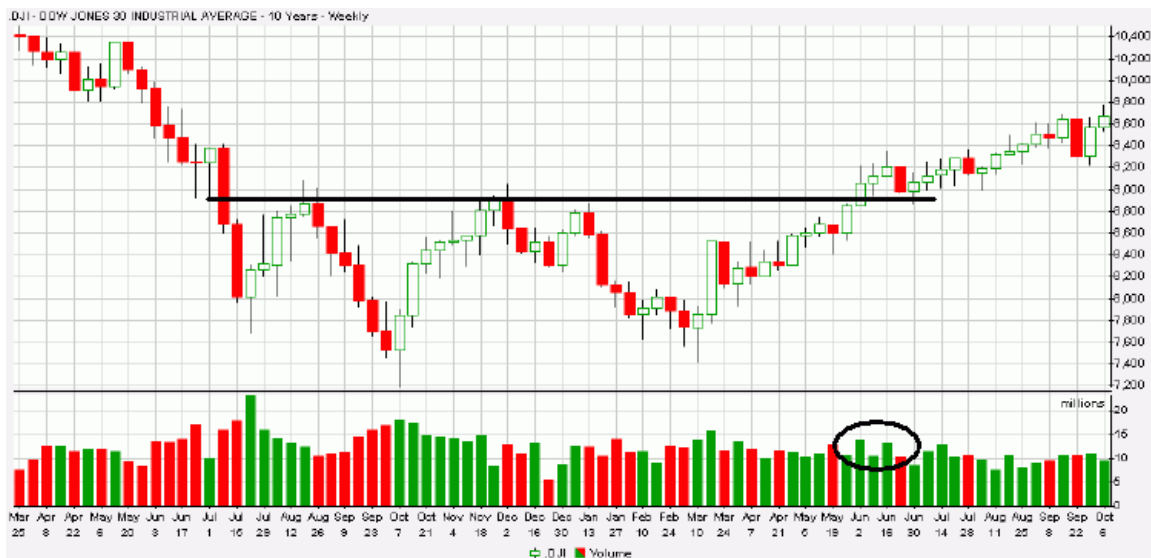
- It is normal for prices to base, consolidate after a major bear market, or move.
- Investors need to see improvement in the economy and especially in earnings and this normally takes time for this happen, normally at least one quarter.
- It takes time for all market participants (investors, traders, institutions, individuals) to turn from bearish at a bottom to bullish. It takes time for everyone to jump into the bullish camp. The same thing happens at a top. Tops take time for participants to go from bullish to bearish.

It is normal for the market to turn positive even though earnings and the economy may still be negative. Investors need to see improvement, not necessarily positive earnings or economy.

Investors may miss part of a good move if they wait to see the numbers actually turn positive. Investors need to be anticipatory.

Examples of Basing, Bear Market Bottoms/Reversal Patterns

Let's look at a base /bottom:



Let's review the bottom of the early 2000s bear market:

- The above chart is of the Dow Jones Industrial Average, DJIA, from early 2001 to late 2003.

- The basing period is the bottom formation that was established between July 2002 and the break out of its resistance in June 2003.

The resistance of the basing period was the 8,900 of the DJIA.

- It took approximately one year for prices to form the base and for prices to break out of its resistance.

- The bottom of the early 2000 bear market was found in September of 2002 and it took approximately 8 months to break out of its base and bear market.

-The basing period took longer than most, suggesting the next move up could be substantial, but you normally need above average volume to corroborate a strong bull market outlook.

Volume was rather weak making the outlook for the next bull market questionable. The bull market of the next five years was mediocre compared to most bull markets.

- We're going to call this a double bottom. Some technicians may call this a triple or even a head and shoulders bottom because of the low made in July of 2002.

We will look at a head and shoulders bottom that was formed in 1991 and is a better example of a head and shoulders bottom.

The above bear market and basing period was associated with a recession.

The previous bear market was in 1998 and this bear market was not associated with a recession. Here is a chart of the basing period for that bear market:



Because there was not a recession associated with this bear market, the recovery and basing period was very short compared to most real bear markets.

Let's review the base/bottom:

- The basing period took only three months, thanks to a healthy U.S. economy.
- A double bottom was formed
- Volume was average

The next period we will look at was really not a bear market and there was not a recession, 1994:



Although 1994 was technically not a bear market, if you were an investor or trader in 1994, you know it was a tough investment environment.

The basing period did take about a year.

We would consider this a bowl shaped bottom.

The next bear market was associated with a recession, 1991. Here is the basing/bottom chart:



Let's review the bottom of the early 2000s bear market:

- The above chart is of the DJIA from mid 1990 to early 1991 and is the basing period.
- It took approximately five months for prices to form the base and for prices to break out of its resistance.

The resistance of the basing period was the low 2,600 of the DJIA.

- The bottom of the 1990-1991 bear market was found in October of 1990 and it took approximately 3 months to break out from the bottom.

-The basing period took longer than most, suggesting the next move up could be substantial, but you normally need above average volume to corroborate a strong bull market outlook.

Volume was above average on the break out, a good sign for the next bull market.

- The bottom is a good example of a head and shoulders bottom.

Below is a table that lists the bear market bottoms, bases going back to 1962.

DATE BTM START	DATE END	BASING IN MONTHS	PATTERN	VOLUME	RECESSION	BTM TO BRK OUT/ MONTHS
Jul-02	Jun-03	11	Double Bottom	Low	Yes	8
Aug-98	Oct-98	3	Double Bottom	Normal	No	2.5
Feb-94	Feb-94	12	Bowl	Abv. Avg	No	10
Aug-90	Jan-91	5	H & S	High	Yes	3
Oct-87	Feb-88	5	Triple Bottom	Low	No	5
Feb-84	Aug-84	6	Double Bottom	High	No	0.5
Sep-81	Aug-82	11	Bowl	High	Yes	0.5
Aug-74	Jan-75	5	Double Bottom	High	Yes	1.5
Jun-62	Nov-62	5	Bowl	Low	Yes	4.5
Average # of Months		7.00				3.94

Let's study the table:

-The first and second columns have the months when the basing starts and ends. We use the month when resistance begins, first column, and when prices break out above resistance and a new bull market is started, second column. This is also called a major market reversal, the end of a bear market and the start of a new bull market.

- The third column has the amount of time each bear market spent basing. The average basing period was 7 months.

-The fourth column has the type of bottom that was established. Just about every bottom is represented except for V-shaped bottoms; as we mentioned earlier, they are rare.

- The fifth column tells us about the volume at the break out. Most breakouts are associated with above average volume, money coming into the market.

-The sixth columns let's us know if a recession was associated with the bear market.

-The last column tells us how long it takes for prices to break out after a bear market low has been made. The amount of months it takes to break out after a bottom is made varies, but the average is about 4 months.

After a major reversal, the new bull market normally lasts 3 to 5 years and usually at least doubles in value.

Below are charts of the rest of the basing periods of the bear markets in the above table:

1987, 1988, Triple Bottom



1984 Double Bottom



1981, 1982 Bowl Shaped Bottom



The 1970s were known as a period of stagflation and the market essentially went sideways. Prices were essentially the same as they were at the beginning of 1970 and 1980. Below is a chart for the 1970s.



1974 Double Bottom

Late 1974 did see a severe decline, bear market and was associated with a recession.



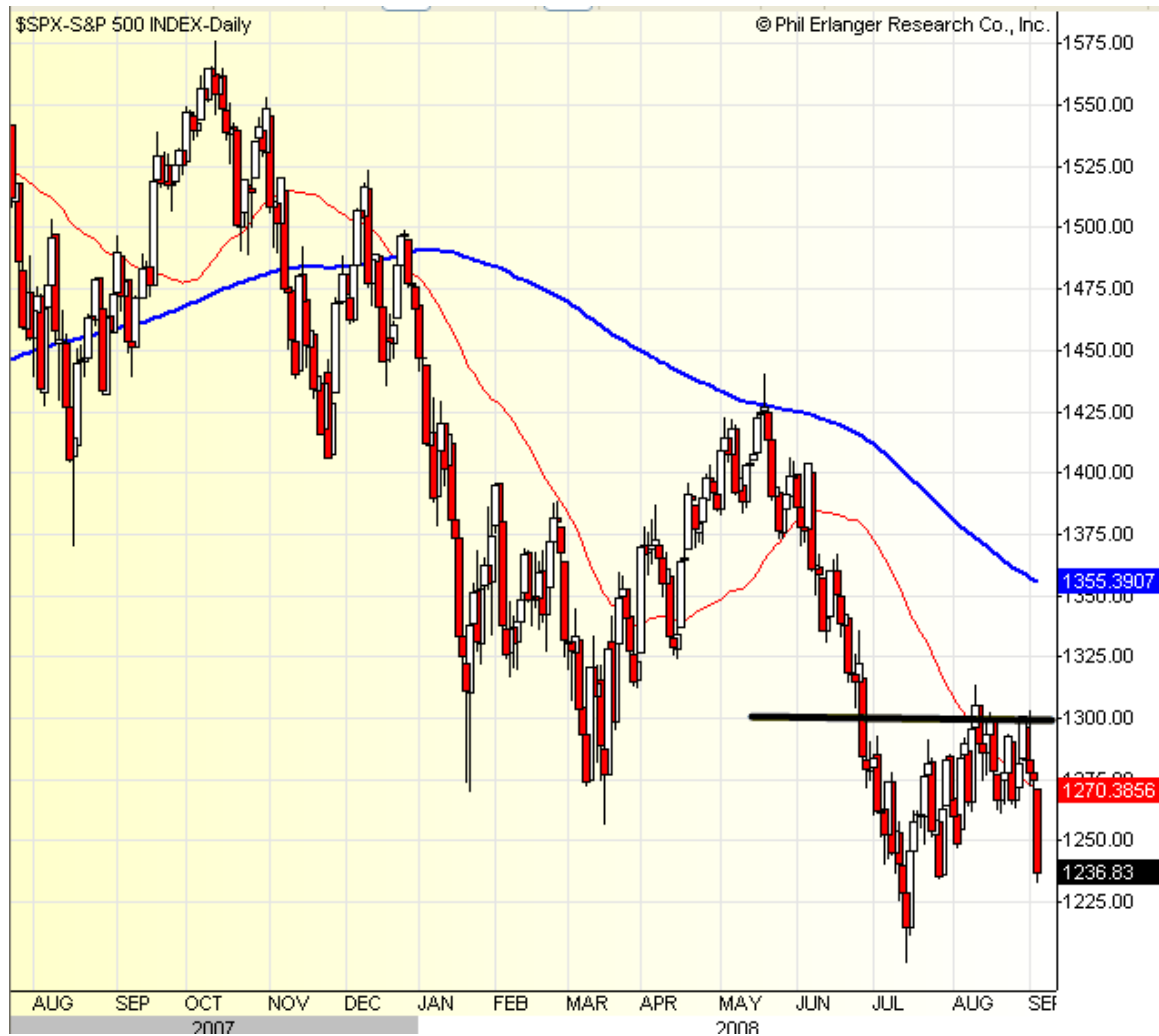
1962 Bowl Shaped Bottom



Now that we understand what a base, bottom is, let's look at today's bear market:

2008 Bear Market

Below is chart for the 2008 bear market:



Let's study the chart:

- Prices are below their 200 (blue) and 50-day (red) moving average line. This is bearish.
- Prices peaked in October of 2007. In our 4th Special Report we learned that most bear markets take about 12 months to find a bottom from a peak, on average. From a time perspective, we are getting close to finding a bottom.

Some analysts are saying that the markets formed a bottom in July. According to historical occurrences, this may not be true. There are enough problems in our economy and markets that we may see lower prices and bottom.

- We are probably now starting to see the beginnings of the basing period and bottom of the bear market or the major reversal pattern of this bear market.

We are perhaps starting to see resistance form at the 1,300 level.

We are starting to see a bottoming pattern start to develop. It's too early to tell what bottom pattern we will have.

- If the average basing period takes 7 months, and the basing period started in June, we may not see a break out until February – according to our table above.

Many analysts are saying this bear market and recession is different than most and it will take more time for our economy including our housing and credit crisis to improve. They also suggest that prices have more downside and once they bottom, prices will only move sideways.

This may be true, but according to historical norms, we are getting close to the last phase of the bear market and investors should start investing during this weakness. If we don't have the normal bull market cycle, then investors will have to learn how to trade these markets. SSI will teach you how.